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Macroeconomic policy questions

External debt sustainability and development

Report of the Secretary-General

Summary

The present report, submitted pursuant to General Assembly resolution 72/204, provides both an analysis of the impact of the main macroeconomic trends in the global economy on developing country debt sustainability and an overview of the development of core indicators of external debt sustainability in developing economies for the period 2008–2017. Given the rapid deterioration of external debt positions across the developing world, the need for improved policy tools to systematically take into account long-term and systemic constraints on debt sustainability is emphasized, along with the need for concerted policy action to avoid structural debt traps in small island developing States with high environmental risk exposure. It is suggested that the assessment of developing country external debt sustainability more thoroughly incorporate considerations relating to the high requirements for additional investment arising from important commitments made pursuant to the 2030 Agenda for Sustainable Development.

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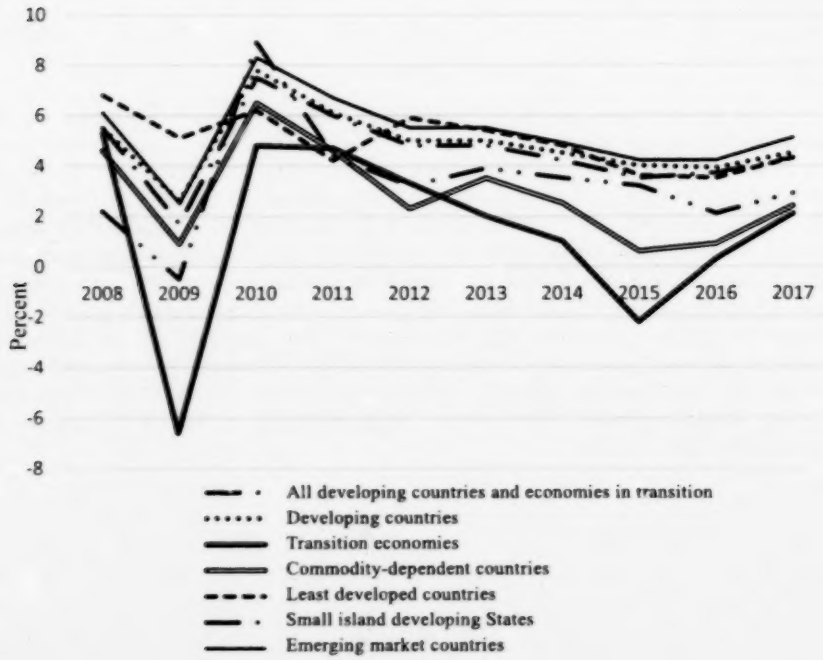
I. The current global macroeconomic environment: fragile expansion and growing financial vulnerability

1. The average rate in growth of gross domestic product (GDP) for all developing countries and economies in transition increased from 3.7 per cent in 2016 to 4.3 per cent in 2017. That marks the strongest growth performance for the group since 2013 and is a welcome development for developing countries whose external debt positions have suffered in the wake of tepid global economic growth in recent years. The uptick in growth in 2017 was experienced across all country groups (see figure I). The strongest increase in growth rates occurred in transition economies (plus 1.8 per cent) followed by commodity-dependent developing countries (plus 1.5 per cent), emerging market countries (plus 0.9 per cent), and small island developing States and least developed countries (plus 0.8 per cent). However, growth rates for all groups remained significantly below those achieved in 2010.

Figure I
GDP growth rates, developing and transition economies, 2008–2017
(constant 2010 US dollars)

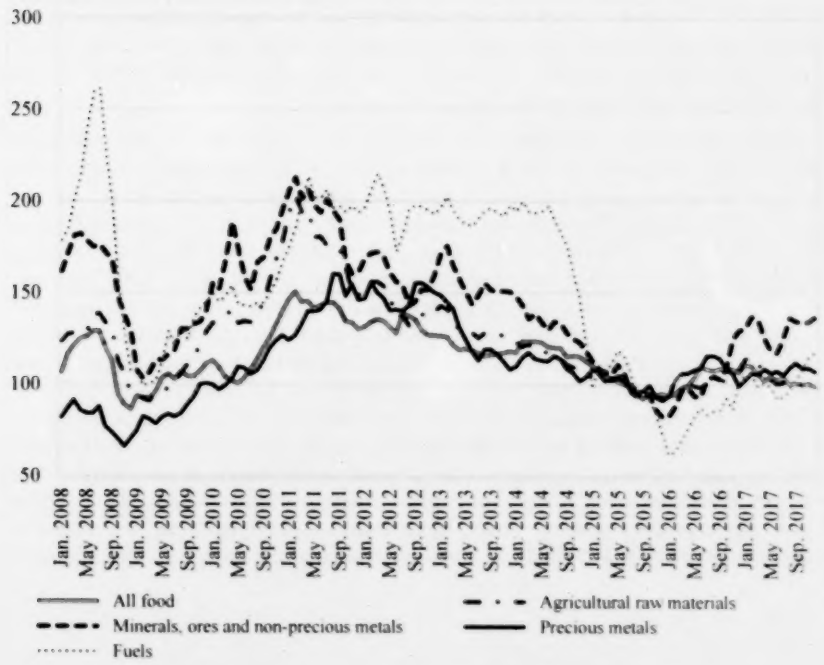


Source: UNCTAD secretariat calculations, based on UNCTADStat and UNCTAD *Trade and Development Report 2018* (forthcoming).
Note: Estimates for 2017 are preliminary.

2. An important supportive factor, from the point of view of commodity-dependent developing countries, has been the recent increase in average commodity prices. From March 2017 to March 2018, average free market commodity prices rose by 13.6 per cent, as measured by the Free Market Commodity Price Index of the United Nations Conference on Trade and Development (UNCTAD). That increase was largely driven by the prices of fuels, which rose by 22.8 per cent, but was offset by declines in the

prices of agricultural raw materials and food by 6.4 and 2.4 per cent, respectively. As figure II shows, the majority of commodity prices also remain significantly below their 2011 peaks. The overall upward trend since 2016 has been fuelled by both supply and demand factors. On the demand side, the broad-based acceleration of GDP growth has contributed to increases in commodity prices. On the supply side, mounting concerns around geopolitical tensions, combined with production restraints by the Organization of Petroleum Exporting Countries, served to push oil and metal prices upward. The greater than expected increases in average commodity prices to date in 2018 can also be attributed to accelerating global growth. By contrast, the sharp decline in average commodity prices in 2015 resulted in a fall in the value of exports from those countries and further widened current account deficits in commodity-exporting economies, with a concomitant detrimental impact on their external debt positions. Overall, therefore, continued volatility in commodity prices has dominated the growth prospects of and policy space in commodity-dependent developing countries through its impact on exchange rate and capital flow volatility, and a concomitant increased risk of debt distress.

Figure II
Free market commodity price indices, 2008–2017



Source: UNCTADStats, UNCTAD Free Market Commodity Price Index 2018, rebased 2015=100.

3. These recent favourable developments for developing countries have to be seen in the context of global expansionary tendencies that have given rise to renewed optimism about short-term global growth prospects.[1] Such optimism has, however,

[1] See, for example, International Monetary Fund (IMF), *World Economic Outlook April 2018: Cyclical Upswing, Structural Change* (Washington, D.C., 2018); and Bank of International Settlements (BIS), *Annual Economic Report. Promoting Global and Financial Stability* (Basel, Switzerland, 2018).

been tainted by growing concerns over downside risks, arising largely from the post-crisis policy mix adopted in most developed economies. This saw the burden of recovery shifted almost exclusively to strongly accommodative monetary policies by central banks and a failure to address structural limitations to achieve a more sustainable expansion of aggregate demand in those economies. In particular, under those policies, the secular fall in the wage share in advanced economies over the past three decades has continued, standing at 54.8 per cent in 2017, marginally below what was then its lowest point on record in 2007.[2] Similarly, at 17 per cent, the average rate of private investment to GDP remained 2 percentage points below the average investment rates in developed economies in the years prior to the global financial crisis. In addition to muted average growth of real government expenditure in most developed economies (with the exception of short-lived fiscal stimuli packages immediately following the global financial crisis), an important contributory factor has been the widely observed increase in market concentration across core sectors in primarily advanced economies in recent years.[3]

4. Rather than stimulating global aggregate demand sustainably by tackling high and rising income inequalities in developed economies, strengthening efforts to support wage growth and providing government services, supporting productive investment strategies and reigning in corporate concentration, global growth acceleration has instead continued to rely heavily on easy financial conditions and short-term expectations of stock market appreciations. As a result, global growth has remained dependent on unprecedented increases in global debt stocks and highly sensitive to amplified reactions to even mildly adverse economic news, or the perception of such, in financial markets.

5. Global debt stocks rose from $168 trillion at the end of 2007 to $247 trillion at the end of the first quarter of 2018. According to UNCTAD estimates, by 2017 the ratio of global debt to GDP was nearly one third higher than in 2008. If the debt of financial corporations is excluded, global debt stocks still increased from $113.5 trillion to $175 trillion over the same period.[4] At the same time, the economic dynamics driving ballooning debt burdens and potential debt crises have changed. A decade ago, unsustainable household debt in the United States of America and excessive borrowing by financial institutions triggered disaster. With core banking sectors in leading economies having deleveraged to a certain extent owing to tighter regulatory measures, the biggest worry at present is non-financial corporate debt in developed and larger emerging economies, with corporate bond markets and non-bank intermediaries playing an increasingly important role relative to core banking sectors. By some estimates, globally, over a third of non-financial corporations are now highly leveraged, with gearing (or debt-to-earnings) ratios of 5 and above, while non-investment-grade corporate bonds have quadrupled since 2008.[5] In addition, regulatory loopholes have facilitated the re-emergence of unregulated financial credit

[2] United Nations global policy model using historical data compiled from the United Nations Statistics Division and national sources.

[3] See, for example, Federico Diez, Daniel Leigh and Suchanan Tambunlertchai. "Global market power and its macroeconomic implications", Working Paper No. 18/137 (Washington, D.C., IMF, 2018); and *Trade and Development Report 2017: Beyond Austerity — Towards a Global New Deal* (United Nations publication, Sales No. E.17.II.D.5), chapter VI.

[4] Institute of International Finance, Global Debt Monitor Database as of December 2017, and UNCTAD secretariat calculations.

[5] See "Global corporate leverage trends 2018" (Standard & Poor's Global, 2018); and Susan Lund and others, "Rising corporate debt: peril or promise?" Discussion Paper (McKinsey Global Institute, 2018).

default swap markets in the shadows, substantially augmenting the danger of cascading financial vulnerabilities in the event of a collapse of underlying markets.[6]

6. The resulting fragility of the current expansionary phase of the global economy has been evident in repeated jitters, such as the stock market tumble at the start of 2018 in response to a slight increase in United States wage growth and expectations of inflationary pressures and similar financial market nervousness about an escalation of protectionist measures. The onset of tightening financial conditions and monetary policies, in particular in the United States,[7] and dollar appreciations further add to financial vulnerabilities and the risk of economic slowdown, in particular in emerging market economies, as witnessed recently in Argentina, Hungary, Indonesia and Turkey. As central banks in advanced countries start to tighten their monetary policies by raising short-term interest rates and further shrinking their balance sheets, a decompression of term premiums (the compensation investors demand for holding bonds in excess of risk-free short-term interest rates) may cause an abrupt tightening of financial conditions.

7. Despite the recent talk of optimism, this scenario holds little promise for developing country external debt sustainability, which has already suffered severe setbacks over the course of several years, owing to boom-bust cycles caused by countercyclical international capital flows and volatile commodity markets, which have, in turn, undermined the domestic policy space and the stable financing conditions needed for development. As highlighted in previous reports (see A/71/276 and A/72/253), the principal difficulty faced by developing countries in regard to maintaining external debt sustainability has been their hastened and often premature integration into rapidly expanding international financial markets and the concomitant increase in the role of private lenders (in particular in larger emerging market economies) and private corporate borrowers in developing country external liabilities, alongside a growing shift towards bond- rather than bank-related finance.

8. As recent research confirms,[8] the post-crisis period has not seen any progress in improving the management of private capital flows for development, with private capital flow volatility continuing unabated after the global financial crisis and involving both greater magnitudes and more pronounced reversals. Most important from the point of view of developing country domestic policy options to address growing exposure to market risk, private capital flow reversals, or "sudden stops", are increasingly driven by external and global factors, such as developed country policy decisions, rather than by factors specific to the developing country in question. This is the case, in particular, for non-foreign direct investment (FDI) flows, such as portfolio flows and other investment, although it should be kept in mind that even FDI flows include inter- and intra-company loans that are increasingly subject to speculative financial and corporate management strategies. That has also meant that developing countries have, on average, been affected by private capital flow reversals despite their strong economic fundamentals, such as having relatively low public debt, small budget deficits, low inflation rates and large reserve holdings.

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[6] See, for example, Michael Greenberger, "Too big to fail U.S. banks' regulatory alchemy: converting an obscure agency footnote into an 'at will' nullification of Dodd-Frank's regulation of the multi-trillion dollar financial swaps market", Working Paper No. 74 (Institute for New Economic Thinking, 2018).

[7] See IMF, *Global Financial Stability Report* (Washington, D.C., 2018).

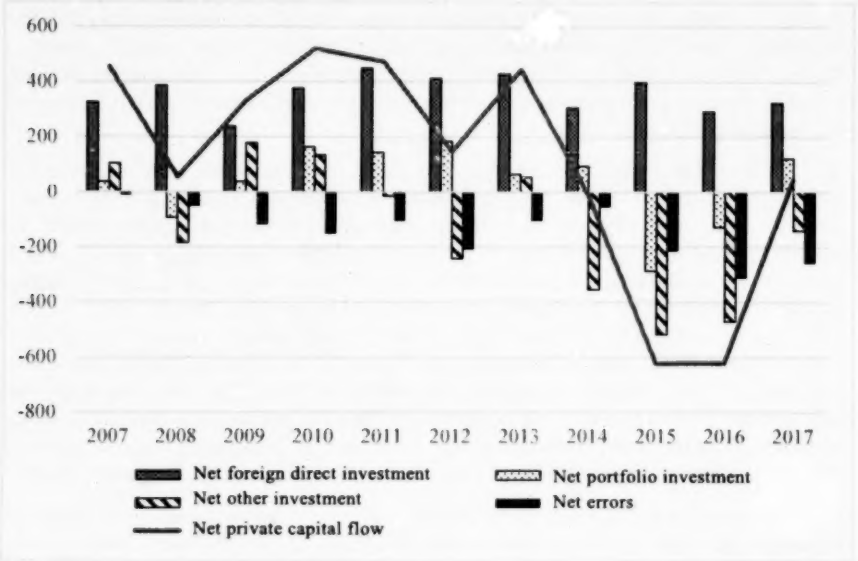
[8] See, for example, Barry J. Eichengreen and others, "Are capital flows fickle? Increasingly? And does the answer still depend on type?", Policy Research Working Paper No. 7972 (Washington, D.C., World Bank Group, 2017); and Barry J. Eichengreen and Poonam Gupta, "Managing sudden stops", Policy Research Working Paper No. 7639 (Washington, D.C., World Bank Group, 2016).

9. Figure III below illustrates the overall volatility of net private capital flows to developing countries, with these remaining positive but unstable in the post-crisis years, until they turned strongly negative in mid-2014, regaining positive territory only very tentatively in early 2017. It also shows the growing impact of net negative capital flows of a speculative nature, that is, net portfolio investment, net other investment and net errors (which broadly reflect illicit financial outflows).

Figure III

Net private capital flow by component: developing countries, 2007–2017

(Billions of current United States dollars)



Source: UNCTAD secretariat calculations, based on data from the UNCTAD Financial Statistics Database, the IMF Balance of Payments Database and national central banks.

Note: The samples of economies by country group are as follows: (1) Transition economies — Kazakhstan, Kyrgyzstan, the Russian Federation and Ukraine; (2) Africa — Botswana, Cabo Verde, Egypt, Ghana, Mauritius, Morocco, Mozambique, Namibia, Nigeria, South Africa, the Sudan and Uganda; (3) Latin America — Argentina, Bolivia (Plurinational State of), Brazil, Chile, Colombia, Ecuador, El Salvador, Mexico, Nicaragua, Paraguay, Uruguay and Venezuela (Bolivarian Republic of); (4) Asia excluding China — Hong Kong (China), India, Indonesia, Jordan, Lebanon, Malaysia, Mongolia, Pakistan, Philippines, the Republic of Korea, Saudi Arabia, Singapore, Sri Lanka, Thailand, Turkey and Viet Nam.

10. The management of the global economy faces a serious dilemma. Although the global economy might successfully navigate repeated financial and stock market jitters arising from factors that have a global impact (such as monetary policy decision-making in developed countries, United States dollar appreciation and tensions surrounding the viability of rules-based multilateral trade arrangements and institutions), without a decisive policy turn in developed countries towards promoting domestic wage growth, improving domestic income distribution and focusing on productive real investment at home and abroad, and, ultimately, a more balanced path towards sustainable growth in aggregate demand, the continuation of current expansionary tendencies will have to rely on easy financial conditions and growing global debt stocks as the main driver of global growth, and, consequently, give rise to growing financial imbalances in both developed and developing countries. The recent tax reform in the United States (representing a net windfall gain of close to 1 per cent of annual GDP growth), alongside a policy agenda advocating renewed

banking and financial sector deregulation, would appear to favour the option of continuing down a path of easy cash and credit injections into corporate and high-wealth sectors, proliferating financial innovation and speculation and growing concentration tendencies in financial and other core sectors, primarily in developed countries.

11. Under that scenario, it is more than likely that financial and deeper structural vulnerabilities in many developing countries will continue to increase to the point of triggering severe financial and external debt crises. Whether the accumulation of financial and debt vulnerabilities in developed country corporate sectors and in developing economies will trigger a new systemic financial crisis is difficult to gauge at present. Another possibility is drawn out and costly episodes of financial and debt distress in many developing countries without major contagion effects. Much might depend on how well relatively healthy and deleveraged banking sectors in advanced economies can weather the fallout from rising non-financial corporate debt and growing shadow-banking activity.

II. Main external debt trends in developing countries, 2008-2017

12. Total external debt stocks in developing countries and economies in transition are estimated to have reached $7.64 trillion in 2017, having grown at an average yearly rate of 8.5 per cent between 2008 and 2017. This is reflected in an increase in the share of developing countries in total global debt stocks from around 7 per cent in 2007 to around 26 per cent a decade later.[9] During the same period, average GDP in those economies grew at 6.3 per cent a year, leading to a deterioration in the ratio of total external debt to GDP from 21.2 per cent in 2008 to 25.7 per cent in 2017. In 2017, 74 per cent of total debt was long-term debt, a decline of 3 percentage points compared to 2008, whereas the share of short-term debt in total external debt increased from 22 per cent in 2008 to 24 per cent in 2017.

13. From 2008 to 2017, the ratio of debt service to exports was at its lowest in 2011, when it stood at 8.7 per cent, whereas 2016 was the worst year, with the ratio reaching 15.4 per cent. The recovery in commodity prices in the second half of 2016 and in 2017 largely accounts for a decrease in the ratio to 13.6 per cent in 2017.

14. The international reserves of developing countries reached nearly $6.5 trillion in 2017, up from $4.3 trillion in 2008. However, the rapidly rising stock of short-term debt, which grew at 10 per cent annually during that period, led to a decline in the ratio of international reserves to short-term debt from 530 per cent in 2008 to 340 per cent in 2017.

15. With regard to the ownership structure of the external debt obligations of developing countries, much of the shift in the composition of external debt from public and publicly guaranteed debt towards private non-guaranteed debt took place in the early 2000s, with the share of the latter rising from 28 to 49 per cent of total external debt between 2000 and 2009. While much of the shift towards private sector indebtedness was led by South and South-East Asian economies, that pattern of indebtedness also spread to sub-Saharan Africa, where private non-guaranteed debt rose from a low share in overall external debt of around 6 per cent in 2000 to around 25 per cent by 2017. At the same time, the share of public and publicly guaranteed debt owed to private creditors increased from just over 40 per cent in 2000 to well over 60 per cent in 2017. Changes in the share of both types of debt in overall external

[9] Institute of International Finance, Global Debt Monitor Database, as of December 2017, and UNCTAD secretariat calculations.

debt and in the share of public and publicly guaranteed debt owed to private creditors have largely stabilized in recent years, with regional variations.

16. Debt indicators for developing countries have also been influenced by China's numbers, as the country's share of total developing country debt stock increased from 11.5 per cent in 2009 to 21 per cent in 2017. Excluding China, the ratio of debt to GDP for developing countries increased from 12.8 per cent in 2009 to 13.6 per cent in 2017, with a peak of 15.6 per cent reached in 2016 when commodity prices weakened substantially. The share of long-term debt in total external debt remained broadly stable over the period, at around 80 per cent, and the share of short-term debt in total external debt oscillated between 17 and 20 per cent. The ratio of debt service to exports soared from a low 8.7 per cent in 2009 to a high of 15.3 per cent in 2016, before easing to 13.5 per cent in 2017. As can be seen below, these aggregate figures largely mask growing financial and debt distress, in particular in the least developed countries.

17. Total external debt stocks in the least developed countries increased from $155 billion in 2008 to $293.4 billion in 2017, representing an average annual rate of growth of 7.4 per cent over that period. Long-term debt as a percentage of total external debt increased from 82.7 per cent in 2008 to 86.4 per cent in 2017, whereas the share of short-term debt in total external debt decreased from 13.5 per cent in 2008 to 9.4 per cent in 2017. The ratio of total external debt to GDP barely changed over the past decade, moving from 27.4 per cent in 2008 to 28.1 per cent in 2017. However, the ratio of debt service to exports sharply worsened over the period, rising from 4.1 per cent in 2008 to almost 10 per cent in 2017, a worrying development should that trend continue in the coming years. During the same period, debt service as a percentage of government revenue more than doubled, increasing from 5.7 to 14 per cent, which diverted resources away from key social projects aimed at attaining sustainable development targets. According to IMF figures,[10] 40 per cent of low-income developing countries,[11] or about twice as many as in 2013, are now at a high risk of debt distress. Moreover, 10 of the 13 countries that have moved into the high-risk category since 2013 are in sub-Saharan Africa. Looking at least developed countries in that region, there has been a marked deterioration in some debt indicators. While the ratio of debt to GDP increased from 25 per cent in 2011 to 31 per cent in 2017 (a change of around 20 per cent), the ratio of debt service to exports almost quadrupled, rising from 3.8 per cent in 2011 to 12.9 per cent in 2017. A dramatic deterioration in the ratio of debt service to government revenue also occurred, from 5 per cent in 2011 to 18.5 per cent in 2017. These developments reflect newly acquired access to global capital markets following the decrease in debt stocks emanating from earlier debt relief initiatives, such as the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative, and increased borrowing at commercial terms by those least developed countries over the past few years, incurring substantially higher debt servicing costs. In parallel, that period was characterized by weak commodity prices, which negatively affected both export revenue and government revenue. The combined effect of those trends has led to a deterioration in both the numerator and denominator of key debt ratios, giving rise to increased fragility in the financial position of a number of least developed countries.

18. Another well-known aspect of growing financial and debt distress among developing countries involves small island developing States. The total external debt stocks of small island developing States more than doubled between 2008 and 2017,

[10] "Macroeconomic developments and prospects in low-income developing countries–2018", Policy Paper (Washington, D.C., IMF, 2018).

[11] The list of least developed countries as defined by the United Nations and the list of low-income developing countries as defined by IMF are nearly identical, the major difference being that the IMF list also includes Nigeria and Viet Nam.

while GDP increased by just over 30 per cent during the same period. As a result, the average ratio of debt to GDP deteriorated across the board, increasing from 28.3 per cent in 2008 to 58.2 per cent in 2017, with some small island developing States facing ratios of debt to GDP well in excess of 100 per cent. The average ratio of debt service to exports also worsened substantially, from 8.6 per cent in 2008 to 19.2 per cent in 2017, while the ratio of external debt to exports rose from 67.4 per cent to a staggering 163.8 per cent during the same period. The ratio of international reserves to short-term debt, which stood at 191 per cent in 2008, reached a high of 344.8 per cent in 2010, but eventually fell to 235.8 per cent in 2017, signalling the limits of self-insurance in circumstances of serious debt distress. Public finances have continued to be suffocated by heavy debt servicing costs, doubling from 16 per cent of government revenue in 2010 to more than 40 per cent in 2015, before easing downward to a still high 34 per cent in 2017. As highlighted below, the plight of small island developing States, mostly comprising middle-income developing countries facing high levels of environmental risk, warrants further attention.

19. Total debt stocks in emerging markets grew at an average rate of 9.5 per cent during the 2008–2017 period, or 1 percentage point above the rate for developing countries as a group. During the same period, GDP growth rates averaged 6.8 per cent, leading to a deterioration in the ratio of debt to GDP from 18.3 per cent in 2008 to 22.9 per cent in 2017. Short-term debt as a share of external debt stock increased from 23 per cent in 2009 to 36 per cent in 2014, and then reversed to settle at 28 per cent in 2017. The ratio of international reserves to short-term debt sharply decreased from a high of 673 per cent in 2009 to 353 per cent in 2017. The ratio of debt service to government revenue reached a low of 8 per cent in 2011, reflecting easy credit and rock-bottom global interest rates in the aftermath of the global financial crisis. That ratio increased progressively to 11.5 per cent by 2017.

20. Although standard external debt indicators for that group of countries are better than those for developing countries as a whole, their relatively easy access to international capital markets exposes them to a specific set of vulnerabilities, largely driven by non-financial corporate borrowing. Thus, borrowing in international capital markets, mostly in dollars, by non-financial corporations in emerging market countries has grown rapidly since the beginning of the millennium. Having stood at $629 billion in 2000, private sector gross debt, largely accounted for by corporations rather than households, ballooned to $21.6 trillion by the end of 2016.[12] It is important to note that high corporate leverage in these economies is now less determined by conventional factors, such as real sector- and firm-specific features of the domestic economic setting, than by global factors such as dollar appreciation and policy decisions in advanced economies. As highlighted by recent currency crises in Argentina, Hungary, Indonesia and Turkey, such economies remain vulnerable to adverse investor sentiments, sudden stops in private capital inflows and domestic capital flight.

[12] IMF Global Debt Database, June 2018.

III. Deepening challenges to external debt sustainability in developing countries: investment requirements under the 2030 Agenda for Sustainable Development and environmental vulnerabilities

A. Rising investment requirements for structural transformation under the 2030 Agenda

21. Borrowing, both by Governments and private entities, is an important tool for financing investment that is critical to achieving sustainable development and for covering short-term imbalances between revenues and expenditures. However, high debt burdens can impede growth and sustainable development. In the context of the 2030 Agenda, developing countries should balance these considerations as they endeavour to harness the potential of external finance to support national development strategies while avoiding the risks of external financial instability.

22. Considerations regarding external debt sustainability play a prominent role in the Addis Ababa Action Agenda, which reflects recognition of the need to assist developing countries in attaining long-term debt sustainability, including through coordinated policies aimed at fostering adequate debt financing, debt relief and debt restructuring, and supporting sound debt management. Such policies include the monitoring and prudent management of liabilities through improved methodological standards and data transparency, the enhancement of processes for the cooperative restructuring of sovereign obligations, the development of financial instruments to support countries that are exposed to economic, social or natural shocks that could undermine debt sustainability, and the promotion of cooperation between lenders and borrowers to prevent and resolve unsustainable debt situations. While it is emphasized in the Addis Ababa Action Agenda that maintaining sustainable debt levels is a primary responsibility of borrowing countries, lenders have a responsibility to lend in ways that do not undermine debt sustainability.

23. Despite this recognition of the need to scale up coordinated policy support for enhanced external debt sustainability in the Addis Ababa Action Agenda, a salient gap in policy analysis concerns the impact of Sustainable Development Goal-related investment requirements on debt sustainability. Such Goal-related investment needs are significant and expected to have a profound impact on fiscal positions and external debt sustainability in developing countries. While estimates vary, depending on model assumptions, there is general agreement that these requirements range in the trillions of dollars annually. A relatively conservative estimate puts the average annual shortfall to finance core Goal-related investments at $2.5 trillion annually throughout the 2015–2030 period, given 2014 levels of investment.[13] At the country level, the scale of the funding gap varies relative to the size of the national economy. Low- and lower-middle-income countries will need to increase annual investments related to the 2030 Agenda by 4 to 11.5 per cent of GDP (17 to 43 per cent in low-income countries and 3 to 9 per cent in lower-middle-income countries).[14] To meet only Goal 1 (End poverty in all its forms everywhere) by 2030, assuming that savings, FDI and official development assistance (ODA) stay at current levels, GDP in Africa

[13] *World Investment Report 2014: Investing in the SDGs — An Action Plan* (United Nations publication, Sales No. E.14.II.D.1).

[14] Guido Schmidt-Traub, "Investment needs to achieve the Sustainable Development Goals: understanding the billions and trillions", Working Paper (Sustainable Development Solutions Network, 2015).

would have to grow at double-digit rates of over 15 per cent per year.[15] To meet those investment requirements, developing countries will need to implement a multipronged strategy for the mobilization of development finance that takes into account country-specific circumstances and the structural limitations imposed by the international monetary and financial systems. As debt-based finance will remain one of the key components of such a strategy, it is increasingly relevant to assess the effective capacity of countries to meet the targets under the Sustainable Development Goals while preserving debt sustainability.

24. As indicated in section I of the present report, the current global economic environment is not conducive to easing pressure on the external debt sustainability of developing countries. In addition, net ODA provided by the members of the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD) continued to fall short of the United Nations target of 0.7 per cent of donor gross national income, amounting to $146.6 billion in 2017, or a decrease in real terms of 0.6 per cent compared to 2016.[16] Perhaps it is more significant that ODA flows to least developed countries have stagnated in recent years.[17] While recent developments have highlighted the external financial fragility of upper-middle-income countries, the sharp increase in debt vulnerability observed in a considerable number of least developed countries is of concern, given their large Sustainable Development Goal-related investment requirements. Median levels of public debt for that group have increased from 33 per cent of GDP in 2013 to 47 per cent in 2017. As a result, the number of least developed countries facing significant debt challenges has increased from 22 to 35, with countries in sub-Saharan Africa accounting for most of that increase.[18] More generally, the combination of a fragile and highly financialized global economic environment, with increasingly limited access to concessional resources, exposes developing countries to a situation in which mounting debt service costs can crowd out public investment in Goal-related projects. Between 2014 and 2017, the number of developing countries for which debt service represented more than 15 per cent of government revenues increased from 21 to 29. For some of those countries, resources for debt service represent several times the budget allocation for Goal-related investment.[19]

25. Against that backdrop, international organizations, including IMF and the World Bank Group, and forums such as the Group of 20 and the Paris Forum, have put a spotlight on the need to enhance downstream debt management capacity in developing countries and to improve debt data recording, reporting, quality and transparency. As highlighted in previous reports (see A/72/253), the renewed policy focus on multilateral initiatives to expand support for capacity-building and technical assistance in that area, currently provided globally by the Debt Recording and Management System of the Commonwealth and the Debt Management and Financial Analysis System of UNCTAD, is very relevant. That extends not only to improvements in the timeliness and accuracy of debt data recording, but to the enhanced coverage of public sector and other relevant debt data, including, in

[15] *Economic Development in Africa Report 2016: Debt Dynamics and Development Finance* (United Nations publication, Sales No. E.16.II.D.3).

[16] Organization for Economic Cooperation and Development, development finance database, accessed May 2018. Available at: http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/.

[17] Inter-agency Task Force on Financing for Development, *Financing for Development: Progress and Prospects 2018* (New York, 2018).

[18] Ibid.

[19] Estimates based on the database of Government Spending Watch on spending in relation to the Sustainable Development Goals. Available at http://www.governmentspendingwatch.org/spending-data.

particular, heretofore unrecorded or hidden debt instruments, contingent liabilities and more complex debt instruments.

26. While improved debt data quality, scope and transparency provide the indispensable foundation on which policy analysis to address financial and debt vulnerabilities can build, the monitoring of macroeconomic and financial risk to debt sustainability poses further challenges. The core tool in that regard is the IMF debt sustainability analysis framework for low-income countries, developed jointly with the World Bank Group, along with the debt sustainability analysis framework for countries that have significant access to international capital markets. The framework for low-income countries helps to guide the borrowing decisions of such countries in a way that matches their financing needs with their current and prospective repayment ability. A comprehensive reform of the framework for low-income countries was approved by the Executive Boards of IMF and the World Bank Group in 2017 and is expected to become operational in 2018. The reform aims to improve the framework's assessment of a country's debt carrying capacity by incorporating additional country-specific information and methodological advances to increase the accuracy in the prediction of debt distress. Such improvements can help to identify borrowing opportunities that support the mobilization of financial resources towards the Sustainable Development Goals without creating additional sources of external debt vulnerability. The framework for countries that have significant access to international capital markets is tailored to assess debt vulnerabilities in countries with durable access to external market financing. Having been updated in 2013 to address shortcomings identified in the aftermath of the 2008 crisis, the framework is currently undergoing further review by IMF.

27. In the context of the 2030 Agenda and high requirements for investment related to the Sustainable Development Goals across developing countries, it may be useful to develop complementary policy tools to assess debt sustainability from a broader perspective. The debt sustainability analysis frameworks are primarily organized around the notion of debt sustainability in terms of a country's capacity to stabilize debt levels without incurring implausibly large income, expenditure or financing adjustments, emphasizing short-term flexibility and the commitment to meet creditor claims. One implication is that, which such analytical and policy priorities, long-term investment towards the Goals may constitute a competing use of resources. For example, high levels of debt might be considered sustainable so long as the country is able to meet creditor claims without having to engage in large-scale policy adjustment, even if it is unable to mobilize sufficient resources to meet Goal-related investment requirements. Alternatively, a debt sustainability analysis framework that prioritizes the short-term ability to repay can potentially lock countries into a low debt and low growth scenario that discourages them from borrowing and investing to achieve the Goals, even if their debt levels are below moderate risk thresholds.

28. An enhanced approach to debt sustainability that incorporates specific development goals was proposed in 2005 by Kofi Annan, then Secretary-General of the United Nations, in the context of the Millennium Development Goals. Under that approach, debt sustainability was defined as "the level of debt that allows a country to achieve the Millennium Development Goals and reach 2015 without an increase in debt ratios" (A/59/2005). An enhanced approach to debt sustainability in the context of the 2030 Agenda focuses on the assessment of investment and financing requirements, consistent with attainment of both core Sustainable Development Goals and stable debt ratios by 2030, to inform sustainable national development strategies. Essential to a framework for debt sustainability assessment that is centred on the Sustainable Development Goals is the integrated consideration of a range of requirements to meet enhanced criteria for debt sustainability, such as targets for economic growth and domestic resource mobilization, medium-term budget

frameworks that account for Sustainable Development Goal commitments in the consideration of both available fiscal space and long-term investment requirements, along with external development financing requirements, in terms of volumes and conditions, consistent with meeting targets under the Sustainable Development Goal and having stable debt ratios.

29. In addition to its role in defining debt sustainability in the context of the 2030 Agenda, an integrated and more comprehensive Sustainable Development Goal-centred assessment framework also facilitates the evaluation of a range of policy options across different areas. In terms of domestic resource mobilization, medium-term revenue strategies can help to develop country-specific targets for fiscal revenue, tax collection and long-term capacity-building requirements, thereby providing a realistic foundation for policy design to address issues relating to tax administration, tax evasion and illicit financial flows. In the context of the assessment of debt vulnerabilities, a medium-term revenue strategy can also provide valuable country-specific insights on the appropriate mix of domestic resource mobilization and sustainable external financing. While some upper-middle-income countries can likely rely entirely on domestic resource mobilization for the investment required to achieve the Goals, middle-income and least developed countries will inevitably require substantive international support to complement their national efforts.[20] For example, lower-middle-income countries may require access to concessional lending facilities to achieve a critical mass of early investments towards the Goals, thereby creating the conditions for the enhanced mobilization of domestic resources in the medium term without a deterioration in their debt ratios, while many least developed countries may need to consider enhanced grant financing or debt relief if they are to achieve the Goals. Furthermore, medium-term budget frameworks are a natural complement to revenue strategies, since the attainment of the 2030 Agenda implies not only significant increases in overall expenditures, but also the re-composition of national annual budgets to prioritize Goal-related investments and to ensure a consistent degree of funding over time. The inclusion of tools to assess the impact of public investment on growth in the newly revised debt sustainability analysis framework for low-income countries is a positive step in that direction.

B. Small island developing States, external environmental shocks and debt sustainability

30. The physical devastation that occurred during the 2017 Atlantic hurricane season put a spotlight on the environmental vulnerability of small island developing States, which also had a detrimental impact on the already unsustainable debt burdens of many of those countries. As climate change is expected to increase the frequency and intensity of environmental shocks, the need for a more systematic and coordinated approach to financing successful climate change adaptation and to supporting external debt sustainability and fast recovery in the aftermath of environmental shocks is widely recognized.

31. A common characteristic of small island developing States, apart from their high exposure to environmental risks, is their status as middle-income countries. Many of those countries face persistent barriers to further structural transformation, for varying reasons, and have struggled to converge towards the performance of higher-income developing countries. Policy initiatives to tackle environmental and growing debt vulnerabilities in small island developing States will need to consider that wider context in order to succeed in helping small island developing States avoid a vicious

[20] Guido Schmidt-Traub, "Investment needs to achieve the Sustainable Development Goals: understanding the billions and trillions".

circle of growth slowdowns and unsustainable debt burdens. An important implication is that measures focusing primarily on insurance or self-insurance strategies, while necessary and helpful, may be insufficient.

32. From the perspective of prevention, substantive and reliable financial support for successful climate change adaption through initiatives such as the Green Climate Fund is essential. In addition, a review of current eligibility and graduation criteria with a view to facilitating the access of small island developing States to concessional finance, despite their middle-income status, for example through the inclusion of environmental vulnerability indicators in eligibility criteria, should be considered to help to improve their prospects for longer-term external debt sustainability. Further development of international insurance schemes and instruments, such as the Caribbean Catastrophe Risk Insurance Facility, will also help to limit the economic impact of natural disasters by providing immediate financial support. Similarly, market-based insurance instruments, such as catastrophe bonds, through which insurance and reinsurance companies transfer risks linked to catastrophic events, and state-contingent debt instruments can be effective in alleviating financial vulnerabilities and preserving external debt sustainability, especially given the limited capacity of small island developing States to pursue self-insurance strategies. Additional resources and efforts will, however, be required to promote the systemic adoption of such financing and insurance instruments in the international financial markets.

33. From the perspective of addressing financial distress in the aftermath of an external shock, existing emergency loan facilities provide vital short-term support and have been expanded. To address growing debt distress in small island developing States, additional policy measures, such as debt relief from private and official creditors, may have to be considered in the short run, while the promotion of longer-term external debt sustainability will require explicitly accounting for climate change adaption needs and the impact of natural disasters in debt sustainability analyses. An example of relevant longer-term initiatives is the proposal by the Economic Commission for Latin America and the Caribbean to create debt for climate adaptation swaps for the Caribbean. That would involve the use of pledged Green Climate Funds to finance the gradual write-down of the multilateral and private debt of small island developing States in the Caribbean, contingent on debtors agreeing to make annual payments into a Caribbean resilience fund in an amount equal to the discounted debt service payments.

IV. Conclusions and policy recommendations

34. Despite recent optimism about global economic growth prospects, the overall outlook for external debt sustainability in developing countries remains worrying and is set to deteriorate further in the near future. Conventional broad statistical indicators of external debt sustainability, such as the ratio of GDP to external debt, are increasingly inadequate to capture the growing complexity of financial and debt vulnerabilities in developing countries, given the rapid integration of developing countries into international financial markets in recent years and the limited domestic policy space in which to address financial stress effectively. Of particular concern are the massive build-up of non-financial corporate debt, including in emerging market economies, the renewed external financial fragility of a number of upper-middle-income countries, and the continued deterioration of external debt sustainability in a growing number of least developed countries and small island developing States. Such vulnerabilities are set to increase in an international context marked by the normalization of monetary policy in advanced economies, reduced capital flows and tighter financial conditions.

35. Recent initiatives by international organizations and forums, including IMF, the World Bank Group and the Group of 20, to support national capacity-building in debt data reporting, recording and monitoring are timely and welcome. In that context, additional technical assistance is needed for the formulation of a consolidated approach to extended coverage of public sector debt, the improved recording of hidden debt, the timely recording of guarantee data, loan disbursements and arrears, along with the improved management of new complex debt instruments, including blended financing instruments. Efforts to improve debt data transparency should also address lender transparency more systematically.

36. Beyond issues of data availability and quality, an effective response to growing debt and financial vulnerabilities in developing economies will ultimately require coordinated macroeconomic policies to promote stable and positive net capital flows to developing countries, contain financial market volatility and stimulate aggregate demand growth in advanced countries by supporting wage growth, improving income and wealth distribution and reigning in excessive market concentration.

37. With such policy reforms unlikely to materialize soon, it is all the more important that existing multilateral initiatives to enhance debtor and creditor cooperation in the prevention and resolution of debt crises are further strengthened. That should include a coordinated effort to promote the implementation of soft-law tools for crisis prevention and resolution, such as the Principles on Promoting Responsible Sovereign Lending and Borrowing, issued by UNCTAD in 2011, the Basic Principles on Sovereign Debt Restructuring Processes, adopted by the General Assembly in 2015, and the operational guidelines for sustainable financing endorsed by the Group of 20 in 2017. In a context of heightened external vulnerabilities, it is also appropriate to reconsider the need for debt relief initiatives and current eligibility criteria for access to concessional finance. That is particularly relevant for middle-income small island developing States that are facing a high degree of environmental risk and is likely to become relevant to a wider range of developing countries, including least developed countries and other middle-income countries, to the extent that their external debt positions further deteriorate.

38. Finally, a core consideration is that policies to improve external debt sustainability take into account structural constraints and longer-term investment requirements. Thus, in the case of small island developing States affected by a high degree of environmental vulnerability, financing tools should go beyond emergency insurance schemes and systematically take into account future investment needs, including in relation to climate change adaptation, in order to avoid lasting debt traps. More generally and given the importance of the 2030 Agenda for structural transformation in developing countries, the impact of high Sustainable Development Goal-related investment requirements on developing country debt sustainability should be considered more systematically. In that regard, the inclusion of external debt sustainability requirements in statistical tools to estimate Goal-related financing gaps at the country level would be of practical value. Doing so would allow policy designers to take into account the Goal-related external financing that is needed to complement domestic resource mobilization and that is consistent with stable and sustainable external debt ratios.

Annex

External debt of developing countries

(Billions of United States dollars)

	All developing countries[a] and countries with economies in transition					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	6 179.5	7 266.7	6 798.1	7 079.0	7 635.3	8.5%	7.9%
Long-term debt	4 360.2	4 913.5	4 929.8	5 234.4	5 613.8	8.0%	7.2%
Percentage public and publicly guaranteed	50.1	49.4	49.7	49.3	49.6	7.6%	7.9%
Percentage private non-guaranteed	49.9	50.6	50.3	50.7	50.4	8.5%	6.7%
Short-term debt	1 684.3	2 236.6	1 752.0	1 726.2	1 898.5	10.0%	10.0%
Debt service	739.5	825.6	844.6	947.1	942.2	6.2%	-0.5%
Debt indicators (percentage)[d]							
Total debt/GDP	24.2	25.5	25.1	25.9	25.7		
Total debt/Exports[e]	95.6	98.9	104.4	114.7	109.9		
Debt service/GDP	2.9	2.9	3.1	3.5	3.2		
Debt service/Exports	11.6	11.2	13.0	15.4	13.6		
Reserves/Short-term debt	390.1	310.7	360.8	352.6	339.9		

	Sub-Saharan Africa					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	383.7	415.0	432.0	463.9	518.8	9.4%	11.8%
Long-term debt	310.4	339.5	355.1	385.7	435.8	10.6%	13.0%
Percentage public and publicly guaranteed	73.7	73.2	74.9	74.9	76.1	10.3%	14.8%
Percentage private non-guaranteed	26.3	26.8	25.1	25.1	23.9	11.7%	7.5%
Short-term debt	52.9	55.1	57.5	59.3	62.6	1.9%	5.6%
Debt service	28.1	32.8	29.4	40.4	40.6	8.6%	0.6%
Debt indicators (percentage)[d]							
Total debt/GDP	25.2	23.4	27.0	30.7	31.7		
Total debt/Exports[e]	94.1	86.1	119.7	140.4	137.3		
Debt service/GDP	1.8	1.8	1.8	2.7	2.5		
Debt service/Exports	7.0	6.8	8.2	12.3	10.8		
Reserves/Short-term debt	359.1	359.9	308.0	284.2	292.5		

	Middle East and North Africa					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	192.1	189.9	199.1	224.7	255.8	6.2%	13.9%
Long-term debt	143.5	143.1	151.9	164.2	190.2	5.4%	15.8%
Percentage public and publicly guaranteed	93.7	93.3	93.3	93.3	95.6	5.6%	18.6%
Percentage private non-guaranteed	6.3	6.7	6.7	6.7	4.4	1.5%	-23.1%
Short-term debt	38.4	36.4	36.5	47.4	50.9	6.2%	7.4%
Debt service	18.6	19.1	17.3	21.7	22.2	0.1%	2.1%
Debt indicators (percentage)[d]							
Total debt/GDP	16.0	15.1	17.0	18.9	22.4		
Total debt/Exports[c]	64.5	61.3	81.3	91.9	92.9		
Debt service/GDP	1.6	1.5	1.5	1.8	1.9		
Debt service/Exports	6.2	6.2	7.1	8.9	8.0		
Reserves/Short-term debt	1 062.8	1 135.1	1 043.4	802.8	733.4		

	South Asia					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	542.1	606.3	636.9	626.7	677.2	8.5%	8.0%
Long-term debt	429.1	488.4	518.6	504.1	535.9	8.1%	6.3%
Percentage public and publicly guaranteed	56.2	55.0	55.3	56.6	56.1	7.5%	5.3%
Percentage private non-guaranteed	43.8	45.0	44.7	43.4	43.9	8.8%	7.7%
Short-term debt	95.8	103.3	103.0	107.0	125.2	10.7%	17.0%
Debt service	58.5	105.7	59.1	86.8	95.2	11.2%	9.7%
Debt indicators (percentage)[d]							
Total debt/GDP	22.1	23.5	23.7	21.7	20.6		
Total debt/Exports[c]	107.7	109.1	126.4	120.2	115.5		
Debt service/GDP	2.3	4.1	2.2	3.0	2.9		
Debt service/Exports	11.3	19.0	11.7	16.6	16.2		
Reserves/Short-term debt	414.9	373.3	412.6	410.9	390.5		

	East Asia and Pacific					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	1 973.7	2 615.1	2 186.2	2 308.4	2 550.5	13.5%	10.5%
Long-term debt	966.5	1 139.4	1 146.6	1 277.2	1 418.5	11.4%	11.1%
Percentage public and publicly guaranteed	47.5	45.0	43.3	41.7	39.6	6.7%	5.6%
Percentage private non-guaranteed	52.5	55.0	56.7	58.3	60.4	16.2%	14.9%
Short-term debt	987.8	1 456.7	1 021.3	1 013.5	1 114.7	16.6%	10.0%
Debt service	172.8	187.3	233.7	245.0	247.1	11.7%	0.9%
Debt indicators (percentage)[d]							
Total debt/GDP	17.5	20.5	16.5	17.1	17.5		
Total debt/Exports[e]	63.4	73.5	64.3	72.6	71.8		
Debt service/GDP	1.5	1.5	1.8	1.8	1.7		
Debt service/Exports	5.6	5.3	6.9	7.7	7.0		
Reserves/Short-term debt	424.5	303.0	380.8	356.9	343.0		

	Latin America and Caribbean					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	1 615.5	1 868.9	1 897.3	1 934.9	2 022.2	8.6%	4.5%
Long-term debt	1 328.6	1 536.5	1 555.8	1 628.1	1 711.5	9.0%	5.1%
Percentage public and publicly guaranteed	50.8	49.6	50.8	52.2	53.0	8.4%	6.7%
Percentage private non-guaranteed	49.2	50.4	49.2	47.8	47.0	9.8%	3.4%
Short-term debt	262.2	308.0	318.4	283.4	289.3	5.9%	2.0%
Debt service	230.8	228.0	265.0	318.7	292.7	7.2%	-8.2%
Debt indicators (percentage)[d]							
Total debt/GDP	29.2	30.4	35.4	36.3	34.5		
Total debt/Exports[e]	145.6	153.8	178.9	186.9	175.9		
Debt service/GDP	4.2	3.7	4.9	6.0	5.0		
Debt service/Exports	21.0	18.8	25.0	30.8	25.5		
Reserves/Short-term debt	296.3	274.0	250.9	288.8	292.7		

	Europe and Central Asia					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	1 472.5	1 571.4	1 446.7	1 520.4	1 610.9	3.6%	5.9%
Long-term debt	1 182.2	1 266.6	1 201.7	1 275.1	1 322.0	4.1%	3.7%
Percentage public and publicly guaranteed	37.7	39.6	39.3	37.0	38.0	6.6%	6.3%
Percentage private non-guaranteed	62.3	60.4	60.7	63.0	62.0	2.9%	2.2%
Short-term debt	247.2	277.0	215.3	215.6	255.9	1.6%	18.7%
Debt service	230.7	252.7	240.2	234.5	244.5	1.0%	4.2%
Debt indicators (percentage)[d]							
Total debt/GDP	43.2	39.1	47.2	51.8	49.4		
Total debt/Exports[e]	143.0	128.2	154.1	177.7	159.8		
Debt service/GDP	6.9	6.3	7.8	8.0	7.5		
Debt service/Exports	22.7	20.6	25.6	27.4	24.2		
Reserves/Short-term debt	303.2	250.5	301.8	307.3	288.5		

	Least developed countries					*2008–2017 annual growth rate*	*2016–2017 growth rate*
	2009–2017	*2014*	*2015*	*2016*	*2017[b]*		
Total external debt stocks[c]	220.1	234.8	249.1	268.0	294.7	7.4%	9.9%
Long-term debt	186.2	201.9	214.0	230.9	254.6	7.9%	10.2%
Percentage public and publicly guaranteed	92.9	91.7	91.2	91.6	92.3	7.4%	11.1%
Percentage private non-guaranteed	7.1	8.3	8.8	8.4	7.7	16.8%	1.2%
Short-term debt	20.7	19.7	22.4	24.9	27.8	3.2%	11.6%
Debt service	13.0	15.2	14.5	18.1	21.2	13.1%	17.2%
Debt indicators (percentage)[d]							
Total debt/GDP	26.2	24.7	26.7	28.3	27.9		
Total debt/Exports[e]	105.9	93.8	122.6	139.3	135.4		
Debt service/GDP	1.5	1.6	1.6	1.9	2.0		
Debt service/Exports	6.3	6.2	7.2	9.5	9.8		
Reserves/Short-term debt	567.9	629.8	540.2	493.7	442.9		

Source: United Nations Conference on Trade and Development calculations, based on data from the International Debt Statistics online database of the World Bank (accessed in 2018).

Abbreviation: Gross domestic product (GDP).

[a] Developing countries as defined by the World Bank.

[b] 2017 estimates.

[c] Total debt stocks include long-term debt, short-term debt and the use of IMF credit.

[d] Data used for ratio calculation have been adjusted in accordance with country data availability.

[e] Exports comprise goods, services and primary income that are exported.